Emerging Institutional Weaknesses in US Regulation?

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Recent developments at the US Federal Communications Commission (FCC) and Federal Trade Commission (FTC) illustrate institutional weaknesses in the regulation of business. Over the past four years the FCC has disengaged from economic analysis and has become openly political in its decisions. Over the past 10 years the FTC has avoided court cases by engaging in settlements of its cases, and is now treating these agreements as common law. Both illustrate institutional weaknesses that undermine rule of law.

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> *If men were angels, no government would be necessary… In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself.*
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> - James Madison, *The Federalist No. 51*

Regulation by what are called independent agencies developed in the US because of weaknesses in regulation performed directly by political bodies, such as legislatures and city commissions, and weaknesses in regulation through private action, such as private lawsuits. Political bodies lacked the technical expertise necessary to make economically sound decisions, were sometimes captured by the regulated entities, and could not be depended upon to keep commitments. Regulation by lawsuit lacked coherence and favored those with the means to engage in private action. The regulatory agencies are considered independent if they are governed by laws that clearly define and circumscribe their authority, are empowered by their governance structure to operate at arm's length from short term political pressures and from industry interests, and are required by law to engage in decision making processes that emphasize information and rigorous analyses.

These formal structures provide *de jure*, but not *de facto* independence and coherence. Regulatory systems are incomplete contracts, meaning that the formal strictures cannot address all contingencies. Thus successful regulatory performance depends in part upon people who are willing to develop and embrace informal practices that adapt to changing circumstances while still aligning with the purposes that underlie the formal laws. It appears that this is failing in at least two US regulatory institutions.

One of these institutions is the US Federal Communications Commission (FCC), which has jurisdiction over broadcasting, telecommunications common carriers, and commercial radio spectrum. The agency was formed in 1934 and inherited its functions from the Interstate Commerce Commission (which had regulated telecommunications common carriers) and the Federal Radio Commission. Today's FCC has five commissioners, one of which serves as the chairman. Three commissioners are from the US President's political party and the other two are not.

The FCC has a history of supporting and using quality economic analyses. Around 1980 the agency launched its emphasis on economics by retooling its Office of Plans and Policy (OPP) to be an in-house, economic think-tank. By 2012 the OPP (which was changed to the Office of Strategic Planning and Policy Analysis in 2003) produced 46 economics working papers that laid the groundwork for the agency's opening telecommunications markets to competition and deregulating competitive markets, using auctions to assign radio spectrum licenses, eliminate implicit cross subsidization in telephone pricing, and diminish the regulation of market structure in broadcast media.

Unfortunately, the FCC under its current chairman has abandoned its use of economic analysis and put itself under almost direct political control. The agency's economists have produced no working papers since 2012. Also, the agency leadership effectively quarantined the FCC economists in 2015 when the leadership prohibited the economists from involvement in the agency's decision to treat internet service providers as telephone common carriers. The agency's chief economist[1] in 2015 referred to the agency decision as an "economics-free zone", not because there was no economic thought in the decision, but because the economics was largely wrong and not provided by the agency's economists.

[1] The FCC's chief economist is an academic economist that agrees to serve a one year term at the agency, primarily to provide fresh guidance to the agency's more permanent economic staff.

When internet service providers appealed the agency decision to the DC Circuit Court, the court allowed that the agency had authority to regulate internet service providers. But Judge Stephen Williams offered a strongly worded dissent, filled with citations to the economics literature, saying that the agency's analyses were so weak that they amounted to little more than "populist rhetorical flourishes."

The FCC has used politics to fill the void created by the decline of economics. The 2015 decision to regulate internet service providers was driven largely from the White House. In 2016 the agency chairman delayed a vote on a telephone subsidy plan called Lifeline so that Democrat congressmen could lobby Commissioner Mignon Clyburn, one of the Democrat appointees to the agency. She had reached an agreement with the two Republican commissioners to place a cap on the amount of the subsidy. The vote delay allowed the Democrat politicians to pressure her, leading her to abandon her agreement with the Republicans and vote with her fellow Democrat commissioners. Also in 2016 the agency launched an effort to regulate cable television set-top boxes. The order initiating the action did not cite work by agency economists demonstrating the need for regulatory intervention, but rather it cited the web site of Senator Edward Markey, a Democrat from Massachusetts, who along with four other Democrat senators and independent Senator Bernie Sanders from Vermont, published a claim that set-top boxes were overpriced.

The recent demise of the agency's independence from politics can be seen in commission voting patterns. From 1994 until Tom Wheeler became chair in 2013, votes at the FCC tended to be unanimous (65 percent when a Democrat was and 58 percent when a Republican was chair). Under Chairman Wheeler that has dropped to 47 percent. Prior to 2013 the commission votes rarely split along party lines. Under Democrat chairmen, about eight percent of votes split along party lines and under Republicans, only four percent did so. Under Chairman Wheeler, 26 percent of votes have split along party lines.

The situation with another regulatory agency – the Federal Trade Commission, which has jurisdiction over antitrust matters and deceptive business practices – is one of an agency creating its own laws. Historically the agency's enforcement of legal mandate was tested by courts, which meant that its work was bounded by its enabling statutes and common law. Over the past decade, the agency has largely ceased using the court system for enforcement actions. Instead it has leveraged its threat of legal action to press businesses to settle cases. For example, over the past decade the agency has pursued over 50 enforcement actions regarding online security. Only two cases have gone to court and are still in the court system, meaning that the courts have not ruled on an agency decision in this space for 10 years.

Since each settlement represents a decision by a business to give up something in exchange for not having to incur legal costs, the settlements constitute a body of agreements that reflect the agency's preferences for what it would like for its authority to be rather than what its authority actually is. The agency is citing these agreements as precedence for new cases, treating them as if they are common law. Indeed the agency and many of its supporters even use the term common law to describe the body of settlements.

What is happening in effect is that the agency's staff and commissioners are using threats of costly court cases to compose what they now treat as the agency's legal authority. In reality this is little more than might makes right and undermines the rule of law that is needed to bound regulatory agencies.

It remains to be seen whether these emerging weaknesses in US regulatory institutions is a passing phase that will be corrected with a new president, or a new normal for regulatory agencies. If it is the latter, it threatens the legitimacy of agency regulation in the country.

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